CONTENTS

	Page
Statement	1
The question involved	2
The statute	2
Argument:	
Where a taxpayer sells property for more than it cost him, he is not entitled to claim a loss even though he receives less than he would have been paid for it on March 1, 1913	3
Conclusion	13

1/3/13

In the Supreme Court of the United States

OCTOBER TERM, 1924

THE UNITED STATES, APPELLANT
v.
HARRIET ROGERS FLANNERY AND J. Rogers Flannery, executors of the estate of James J. Flannery, deceased } No. 527

APPEAL FROM THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

STATEMENT

This action was brought in the Court of Claims by the executors of the estate of James J. Flannery, deceased.

Flannery had bought 423 shares of stock of the Flannery Bolt Company before March 1, 1913, for *less* than $225.00 a share. Its value on March 1, 1913, was $275.00 a share. He sold it in October, 1919, for $225.00 a share. He died on March 6, 1920.

His executors filed a return of his income for 1919. In it they claimed a loss based on the difference between the value of the stock on March 1, 1913, and the actual price received for it in

1919. Although the stock was sold for more than it had cost, this difference of $50.00 a share was deducted in the return as a loss in computing the net income of the taxpayer.

The Commissioner of Internal Revenue disallowed the loss taken on the sale of the stock. The collector of internal revenue at Pittsburgh, Pennsylvania, demanded payment of additional taxes on the deceased's income for 1919, of which $7,440.67 was attributable to the deduction which had been made as a loss on that sale of stock. The executors paid the amount so demanded under protest on June 11, 1923. Thereafter a claim for refund was duly filed and rejected.

The executors then brought this suit in the Court of Claims to recover the said sum. That court rendered judgment in their favor. The case is here on appeal from the final judgment of the Court of Claims.

THE QUESTION INVOLVED

The question involved is whether Flannery sustained a loss in the year 1919 by selling the stock for more than it cost him, though he sold it for less than its value on March 1, 1913.

THE STATUTE

The pertinent provisions of the Revenue Act of 1918 (Act of Congress, approved February 24, 1919, 40 Stat. 1060–1067) are as follows:

> Sec. 212. (a) That in the case of an individual the term "net income" means

the gross income as defined in section 213, less the deductions allowed by section 214.

* * * * *

Sec. 214. (a) That in computing net income there shall be allowed as deductions:
* * *

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *.

Sec. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof;
* * *.

ARGUMENT

Where a taxpayer sells property for more than it cost him he is not entitled to claim a loss even though he receives less than he would have been paid for it on March 1, 1913.

It will be noted that the taxpayer derived a profit from the transaction and that the question is whether he is entitled to claim a loss because the stock sold for less in 1919 than it would have brought in 1913, where that sale was for more than the original purchase price.

In other words, can a taxpayer lessen his contribution to the Treasury by deducting a paper loss which was no loss in fact but in the instant case an actual gain? Is it conceivable that Congress, when it permitted the taxpayer to lessen his burden to the extent of an actual loss intended to enable him to profit when there was no loss in fact? Certainly the instant case presents a novel way of escaping taxation if actual profits may be charged as paper losses.

Were this a case of first impression the common sense of the proposition and the great end of taxation would seem determinative, but the question has already been decided by this Court in *Goodrich* v. *Brewster,* 255 U. S. 527, and *Walsh* v. *Brewster,* 255 U. S. 536. While the instant case presents the question from a different angle, it virtually attempts to reargue the principle involved in those two decisions.

The statute makes no distinction between gains and losses. They are grouped together and made parts of one system, for Section 202 makes the same rule applicable whether it be a "gain derived or loss sustained." Unless, therefore, this court desires to depart from its ruling in the cases just cited, it must be presumed that whether the taxpayer is credited with a loss or debited with a gain, the loss or gain must be a reality and not a fiction of bookkeeping.

In *Goodrich* v. *Edwards,* 255 U. S. 527, 535, stock worth $291,600 when acquired in 1912 and

worth $148,635.50 on March 1, 1913, was sold for $269,346.25 in 1916. The court held that no gain was realized on this investment although it had been sold for much more than could have been realized on March 1, 1913.

In *Walsh* v. *Brewster,* 255 U. S. 536, this court passed upon two transactions which are pertinent. Bonds were purchased in 1899 for $191,000 and sold in 1916 for the same amount. On March 1, 1913, their market value was $151,845. The court disregarded the value in 1913. It simply compared the original cost with the amount obtained at their sale and said that as there had been no profit on the entire period there could be no tax. Other bonds bought in 1902 and 1903 for $231,300 were worth $164,480 on March 1, 1913, and were sold in 1916 for $276,150. This court decided that the taxable gain was only the advance over the original cost and not the advance over the value on March 1, 1913.

In these cases the court held that the gains did not consist in the increase in value over that on March 1, 1913, but only the increase, if any, over the original purchase price.

The decision of the Supreme Court of New York in *Bush* v. *Law et al., State Tax Commission,* 206 N. Y. App. Div. 800, 201 N. Y. Supp. 513, is directly in point. The provisions of the New York income tax law concerning the ascertainment of gain and loss are in the same terms as those of the federal income tax law herein involved, save only

that in the New York law the date of January 1, 1919, corresponds to the date of March 1, 1913, in the federal law. In the *Bush case* property bought by a taxpayer before 1919 had increased in value until January 1, 1919, but was sold in 1919 for a much smaller sum than could have been obtained on the first of January, but still at a profit over the cost. The state tax commission assessed an income tax on the profit derived and refused to allow a deduction for the alleged loss by the sale at less than the value of January 1, 1919. On appeal this determination was confirmed by the supreme court. That court relied upon its earlier decision in *People ex rel. Klauber* v. *Wendell,* 196 N. Y. App. Div. 827, and other cases, as to gain, in which it had construed the state statute in the same manner as this court had construed the federal statute in *Goodrich* v. *Edwards* and *Walsh* v. *Brewster,* and had cited those cases, although the New York court had reached the same conclusion upon independent reasoning.

In the *Goodrich* and *Walsh* cases the court considered only actual gains between purchase and sale and not paper gains over prices which could have been obtained in March, 1913. In the New York case the supreme court of that state refused to consider paper losses, saying that only actual losses could be taken into the account.

It is submitted that there is nothing in the income tax law which justifies the conclusion that Congress intended to declare that there had been

a loss because between the time of purchase and sale there had been an intermediate higher value in 1913, in view of the decision of this court that the existence of a gain did not follow from a lower value in 1913 than the value at the time of the earlier purchase or the later sale. The Revenue Acts levying income taxes have taxed as income gains received by the taxpayer, but have allowed few deductions, so that while the words defining income or profits or gains have been general, the definitions of losses have been particular and exact. Thus under the Act of 1913 all gains were taxed as income, but only losses " incurred in trade " could be deducted. While the taxpayer must pay taxes on gains or profits from any transactions, many losses could not be deducted, as, for instance, losses from illegal transactions or losses sustained from the sale of his automobile or his residence. So that all gains have been taxed as income, but not every loss may be deducted. And in no case does it allow any deduction which is not an *actual* loss.

To return to the sections now under consideration, it seems clear that actual gains and actual losses and not paper gains or paper losses were within the purview of the act. The words " gain " and " loss " are used together throughout the act as correlative terms; the method of determining whether there has been a gain applies equally to the determination of whether there has been a loss.

In accordance with the decision in the *Goodrich* and *Walsh cases* two questions may arise:

(1) Has there been a gain or loss?

(2) If there has been a gain or loss, the extent of the gain or loss.

But in accordance with those cases the first question must be answered first. If there has been no actual gain upon the entire transaction, no income tax may be laid. If there has been no actual loss upon the entire transaction, no deduction for loss may be claimed. This court has so decided as to gain. The same rule should apply to loss.

As there was no actual loss in the present case—no more than a paper loss as compared with March 1, 1913—no further question arises. Only if an actual gain or an actual loss were proved would the computation of the amount of the gain or loss be material. Only in such a case would the 1913 value call for consideration. The wording of the statute " losses sustained " requires in unmistakable language the existence of a *loss* before anything may be deducted. Where the taxpayer has not sustained an actual loss but has made a profit on the transaction, there is no loss which he may deduct. That is the case at bar.

It was argued in the court below and that court was evidently misled by the argument, that Section 202 of the law applied to this case and showed that there was a loss. It reads:

> Sec. 202 (a). That for the purpose of ascertaining the gain derived or loss sus-

> tained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date,

But it does not read " for the purpose of ascertaining *if there was* a gain derived or loss sustained." The question of a gain or a loss is a preliminary matter to be determined. The words " for the purpose of ascertaining *the* gain derived or loss sustained " assume that it has already been determined if a gain or a loss has occurred in the instant case.

The meaning of the statute is to be sought in the language of the act itself, the lawmaker is presumed to know the meaning of words and the rules of grammar, and no ambiguity or hidden meaning or intent is to be presumed or sought out.

In *United States* v. *Goldenberg*, 168 U. S. 95, 102, this Court said:

> The primary and general rule of statutory construction is that the intent of the lawmaker is to be found in the language that he has used. He is presumed to know the meaning of words and the rules of grammar. The courts have no function of legislation, and simply seek to ascertain the will of the legislator. It is true there are cases in which the letter of the statute is not deemed controlling, but the cases

> are few and exceptional, and only arise when there are cogent reasons for believing that the letter does not fully and accurately disclose the intent. No mere omission, no mere failure to provide for contingencies, which it may seem wise to have specifically provided for, justify any judicial addition to the language of the statute.

And in *United States* v. *Standard Brewery*, 251 U. S. 210, 217, it was said:

> Nothing is better settled than that in the construction of a law its meaning must first be sought in the language employed. If that be plain, it is the duty of the courts to enforce the law as written, provided it be within the constitutional authority of the legislative body which passed it. *Lake County* v. *Rollins*, 130 U. S. 662, 670, 671; *Bate Refrigerating Co.* v. *Sulzberger*, 157 U. S. 1, 33; *United States* v. *Bank*, 234 U. S. 245, 258; *Caminetti* v. *United States*, 242 U. S. 470, 485.

Now, it is not possible to construe the phrase "for the purpose of ascertaining the gain derived or loss sustained" to mean "for the purpose of ascertaining *if* a gain was derived or loss sustained." The phrase, in the correct use of English, which is conclusively presumed, can be applied only *after* it has been ascertained that there was a gain derived or a loss sustained. This section is of no possible aid or benefit to the tax-

payer to show that when he sold the property at a profit he thereby sustained a loss.

So it was said by this Court in construing this section with reference to gains under the Revenue Act of 1916:

> Section 2 (c) is applicable only where a gain over the original capital investment has been realized after March 1, 1913, from a sale or other disposition of property.
> *Goodrich* v. *Edwards,* 255 U. S. 527, 535.
> *Walsh* v. *Brewster, supra.*

And the same conclusion is irresistible as to a loss. In the 1918 Act the wording of this part of the phrase is exactly the same as in the 1916 Act quoted by this Court, except the words "or loss sustained" are inserted after the words "the gain derived."

It is very evident that Congress intended to establish a uniform, harmonious, and consistent basis for ascertaining gains derived and losses sustained in computing net income for purposes of taxation in the Revenue Act.

This is made even more evident in the Act of 1918 than in the Act of 1916. For in the 1916 Act, Sec. 2 (c) contains the provision "for ascertaining the gain derived," etc., and Sec. 5 (a) Fourth, contains the provision "for ascertaining the loss sustained," etc. While in the 1918 Act these are contained in one section and in one sentence, viz: "Sec. 202 (a). That for the pur-

pose of ascertaining the gain derived or loss sustained," etc. The placing of these in one sentence and in the alternative shows positively that the same transaction can not be both a gain and a loss, as is contended by the appellees, and shows that Congress intended the same general rules of construction and interpretation to apply to "gain" and "loss."

In *Goodrich* v. *Edwards* and *Walsh* v. *Brewster, supra,* this court held that the language of the Act as applied to gains means only those *actual* gains which constitute the difference between cost and selling price. It necessarily follows that there should be a similar construction of this language with respect to deductible losses. That is to say, it was intended to prevent the deduction of anything but actual losses, viz, the difference to the taxpayer between selling price and cost of the property sold. Any other holding would make practically the same language mean one thing with respect to gains derived and another thing with respect to losses sustained, thereby nullifying the plain intent of Congress.

The decisions of this Court in *Goodrich* v. *Edwards* and *Walsh* v. *Brewster, supra,* are decisive of the case at bar. Those decisions are based upon the clear, plain meaning of the Act of Congress, and necessarily follow the correct use of the English language in that Act.

CONCLUSION

It is therefore submitted that as the taxpayer derived a profit from his transaction, he cannot claim he has sustained a loss, and he is not entitled to deduct any sum for an alleged loss; that the judgment of the Court of Claims should be reversed, and that the entry of a judgment for the United States should be directed.

Respectfully submitted.

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